**STATEMENT**

by

**Bay Area Development Company**

on

**The Small Business Administration**

# 504 Loan Guaranty Program, Reauthorization & Other Program Issues

Submitted to the

**COMMITTEE ON SMALL BUSINESS & ENTREPRENURSHIP**
**UNITED STATES SENATE**

by

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I am Jim Baird, Executive Director of Bay Area Development Company of Walnut Creek, California. As one of the original CDCs in the program, I am here to represent our CDC and to provide the perspective of an experienced CDC operating in the field.

I would like to thank Chairperson Snowe, Ranking Minority Member Kerry and the entire Committee for giving me the opportunity to provide remarks on the SBA's 504 program to the Senate Small Business & Entrepreneurship Committee. Moreover, I would like to personally thank the leadership and the committee for steadfastly championing small business issues, including those of the 504 program, and for introducing legislation that, for the 1st time in 25 years would define in statute the specific legislative framework as to how the our industry should be best structured and how the 504 program best operate.

Bay Area Development Company was founded in 1981 and operates in Northern California with a focus on the greater San Francisco Bay Area. In its 25 years of operation, our CDC has provided over $600 million of 504 financing to over 1,100 companies resulting in over $1.8 Billion in total direct investment and in the creation and retention of over 12,000 jobs.

In addition to our 504 economic development activities, in the last four years, our CDC has provided our communities with over $240,000 of economic development sponsorships and community development grants, and we donate hundreds of hours each year serving on boards for organizations as diverse as The East Bay Leadership Foundation, Oakland Children's Hospital, The Alameda County SBDC, and the California Environmental Redevelopment Fund. A copy of our CDC's FY2005 Annual Report has been provided along with my testimony.

**504 in an Environment of Change**

Our industry is operating in an environment of great change. In addition to significant changes in the economy, in the lending environment, and in interest rates, over the last 2 years, every CDC in the 504 industry has experienced the implementation of universal statewide, and multi-state competition, and the advent of nationwide centralized processing of all 504 loan originations.

I thank the Leadership, Members and staff of the Committee for recognizing the implications of these significant changes, and the resultant need to provide a more definitive legislative framework for the optimal implementation and growth of the CDC industry and the 504 program for the long term benefit of America's small businesses and communities.

**Is Change Good or Bad for 504?**

To date, the recent changes in 504 have been very good for our industry in general. It has created a significant surge in 504 volume and has resulted in regions and entire states that had been historically underserved by 504to begin to develop 504 capacity. Nationally 504 loan volume has increased by an average of about 20% in numbers of loans and 30% in $ of loans per year from FY 2002 thru FY 2005. Results for the current fiscal year indicate continuing substantial growth, in short: more loans for more small businesses, and more economic development for our communities.

Change has been good for the 504 program, but it also has its pitfalls. For example, significantly increased competition could cause some CDCs to do inappropriately structured lending which would result in higher losses and ultimately higher interest rates for our borrowers. Increased competition may cause some CDCs to neglect their responsibilities as local economic development organizations or could cause some CDCs to focus only on the largest potential markets, to the disbenefit of underserved small businesses in rural America or urban core areas.

There are also the challenges that program growth and success bring, including a need to insure that the centralized processing and servicing centers have adequate staff to produce workable turnaround times for small business applicants, to maximize recoveries on defaulted loans, and insuring that the Agency has adequate resources to effectively oversee a substantially larger program.

Given the issues above, it is my hope that the legislation that the committee is currently working on will move forward and will result in maximizing the effectiveness of both the CDC industry and the 504 program in the communities we serve.

**The Value of CDCs as Non-Profit Economic Development Lenders**

As non-profit economic development lenders, CDCs provide unique benefits to small businesses, to the SBA and the communities we serve that are not always understood or appreciated.

While for-profit lenders have a responsibility to maximize return to their shareholders, CDCs have a responsibility to maximize return to small businesses and the communities we serve. This mission driven versus profit driven approach has resulted in substantial value to the economic development of our communities over the last several decades.

There are several areas where this added value is often overlooked that are critical to a non-profit CDC's role in providing economic development through the SBA 504 program.

1. **CDCs, as non-profits, are able to provide the 504 and other programs at an extraordinarily low cost to the nations small businesses.**
The non-profit structure of CDCs allows us to deliver the 504 at a cost significantly lower than those that would be required by for-profit SBA lenders. For example, it has been estimated that on a comparable $1 million small business real estate financing, a CDC makes total fee income of less than 1/5$^{th}$ of what a for-profit lender requires. The beneficiaries of this low cost are the small businesses we assist and the communities that benefit from their growth in terms of jobs and investment.

2. As organizations created and primarily regulated by the SBA, non-profit CDCs play a critical role in **balancing the interests of Small Businesses, the SBA and the Community** on every transaction undertaken. CDCs are required by SBA to have an active and knowledgeable staff, board of directors and loan committee to insure that the CDC has appropriate internal guidance and controls and local knowledge, to operate proactively, but also responsibly. CDCs are not disinterested third parties, but partners to the SBA in all their programs, providing support and expertise that represent an important component of the SBA infrastructure at the local and regional level.

3. Also very important is that, as non-profits, **CDCs reinvest in their communities in order to fully meet the economic development mission that Congress and the SBA have charged them with**. Clearly, the top economic development priority of most CDC is making 504 loans in a proactive and professional manner to diverse populations throughout all areas of each CDC's market. However, CDCs must also ensure that their resources and expertise are available and utilized by the communities they serve based on each community's distinct needs. This is often accomplished by implementing non-504 economic and community development activities in all of the regions or states in which they are active 504 lenders.

Although CDCs have many other jobs to do in implementing 504, my opinion is that **it is the combination of these three critical roles** as: 1) A lowest cost service provider; 2) An intermediary that can successfully balance the interests of small businesses and the SBA; and 3) Commitment to a significant economic development mission, **that together represent the hidden value of the CDC of the CDC industry that is not realized or accounted for, and that demonstrates the incredible return provided by these mission-driven organizations.**

**Other Program and Industry Issues**

In addition to the issues above, I would like to submit comments on the following overall program and industry issues:

**A. SBA's proposed 504 authorization for FY 2007**

The Administration proposes an authorization ceiling of $7.5 billion for FY 2007, which is the same as the current FY 2006 ceiling. With 504 program demand by small businesses growing at a rate of over 30% year-to-date, our industry believes we will end this fiscal year with usage at almost $7.0 billion.

We expect 504 program demand to continue at a high level well into FY 2007 as CDCs and banks team-up to use 504 to offer their clients the best financing for their needs. However, the Administration request would provide only about 7% growth. I believe this to be insufficient to meet expected demand for this loan program.

As the Committee knows, the 504 program has been at "zero subsidy" since 1997. This means that there is no cost or appropriation to the taxpayer for the program. It is fully paid for by user and lender fees. In fact, budget information provided by SBA reveals that the 504 program has actually provided excess fees paid into the U. S. Treasury over about $300 million since going off budget in FY 1997.

Given this, I urge the Committee to increase the loan authority for FY 2007 to ensure that small businesses are not turned away from SBA or 504. Our industry suggests $8.5 billion in loan authority, which is $1 billion more than the Administration proposed budget.

**B. The Proposed New Loan Fees**

The Administration proposes that a completely new user fee be added to the 504 program, and to the two other largest financing programs of the Agency for FY 2007. The fee would be levied on all 504 loans that exceed $1 million, which SBA estimates would impact at least 15% of our program's borrowers. The fee would is projected to be 11 basis points of the guaranteed 504 second mortgage loan amount, according to SBA sources. While not specified who would pay this fee, we believe that the small business borrowers would absorb its cost through either cash payments to SBA or increased fee costs for their loans.

Our industry has two concerns about this fee proposal:

First, it will be a new burden on thousands of small businesses that will increase the cost of their loans in both the 504 and 7a programs. It will likely dampen demand for 504 and possibly 7a loans, and thus decrease the availability of capital and job creation for many small businesses.

Second, such a new fee opens the door to unlimited increases in this revenue to SBA. It could lead to substantial growth in fees to cover all sorts of new agency expenditures. It could lead to the entire loan administration process being "off budget", and therefore it may no longer under the full and necessary oversight of Congress. As a result, our industry and I urge the Committee reject this new fee.

**C. Loan Defaults and Liquidation**

504 is a loan guarantee program for which the primary operating costs are the losses incurred from any defaulted loans. However, with all projected loan losses covered by fees paid by the small business borrower, our first mortgage lender, and by CDCs, the program already operates at a "zero subsidy.

SBA has recently spent considerable time and resources dealing with the 7(a) program loan defaults, and created a centralized liquidation center in Herndon, Virginia, solely for the processing of 7(a) defaults. While we applaud those efforts, unfortunately, they haven't been matched or even approached, as it relates to 504 liquidation support.

The long awaited SBA regulation on 504 liquidation was recently published for public and industry comments. In the proposed regulation, SBA rejected a recommendation by our industry to make participation in the liquidation of its defaulted loans mandatory for all CDCs. We believe that it is critical to maximize CDC participation in the liquidation process in order to maximize Agency recoveries, particularly in view of the huge across the board staffing cuts at the SBA District Offices, that previously handled liquidations.

In addition, our industry has not been able to obtain current data on the status of loan defaults for the past three years. This level of totally unnecessary secrecy could undermine all of Congress's long term work to create and improve this program, and our industry's work with the Agency to make so many program improvements over the 504 program's 25 year history.

Failure to improve the liquidation and recovery efforts for 504 defaulted loans will result in totally unnecessary increased fees for future 504 small business borrowers for years to come.

For these reasons, I ask the Committee to pass the provisions of both Senator Snowe's and Senator Kerry's bills that require SBA to make needed changes to its proposed liquidation regulation.

**Conclusion**

Through 504, SBA provides the largest and most successful dedicated economic development program the Federal government has today. Its real value to America is significant, and far beyond the statistics of numbers and dollars of lending done each year. The jobs and community development 504 creates and the business growth it fosters, benefits employees, business owners, their communities, and government at all levels.

Our industry would be honored to be able to continue working with the Committee to complete a comprehensive 504 bill that will make the program more attractive to and less costly to our small business borrowers.

I hope that the committee to continue their work in them, and believe that passage by the Senate, and then their adoption into the law of the land will insure that 504 will be able to accomplish so much more, now and well into the future. .

Again, I thank the Leadership, Committee Members and Committee staff for its tireless work in support of SBA and the 504 program and look forward to another successful year of creating more jobs and assisting in the community development of our Nation.